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FARM MUTUAL INSURANCE COMPANY MERGERS

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Summary

Three important areas in farm mutual merger action are considered: the economic, the human element, and the financial. The following check list summarizes important items.

1. Lower cost insurance for farmers
2. Increased member services
3. Reduced operating expenses
4. Enlarged geographic area of operation
5. Increased lines of coverage
6. Greater opportunity for company survival
7. Greater management income and higher quality management
8. Present company situation
9. Future of the economy in terms of economic growth and policy-holder needs for insurance protection
10. Trends in agricultural production in the proposed operating territory
11. Trends in the general population in the proposed operating territory

12. Trends in coverages offered, price and service offered by competing companies.

In examining the economic consequence of merger, the following should be considered:

13. The use of facilities
14. Product line (lines of coverage)
15. Use of personnel
16. Operating practices.

Attention to the human element falls in three areas: employee relations, member relations, and general public relations. Effective communications should be maintained in all three. The following should be considered:

1. Pride of identity
2. Advanced planning to cover each area
3. Anticipation of problems in each area
4. Advising people what to expect and what not to expect from the proposed new organization
5. Advise people that long-standing rivalries will have to be overcome

This publication draws heavily on material in Mergers for Stronger Cooperatives, Reprint 208, April 1961, Farmer Cooperative Service, USDA. This source is particularly recognized. The assistance of J. H. Atkinson and J. C. Snyder is also specially acknowledged.

6. Members will need to participate in the new organization for it to be effective

7. How existing employees will find employment

8. How job status can be maintained for employees

9. How employee loyalty to the new organization will be developed

10. How loss of community status will be overcome

11. How the general public will be informed and acceptance will be gained for the goals and objectives of the new organization.

The following financial areas are of importance:

1. Valuation of assets
2. Payment for assets
3. Projecting the financial position.

This publication deals with one method of farm mutual insurance company growth--merger. Contemporary economic conditions often suggest this as the most efficient and, in some cases, the only means of growth. Other methods such as increasing the size of business from an existing company base are important as growth avenues. Setting forth the conditions that should or should not lead to merger is outside the scope of this publication.

Emphasized here are the merger problems of smaller specialized farm mutual insurance companies. However, the frame-work here developed can apply to other business firms serving agriculture and to some extent to farm firms which face the need to enlarge. Efforts are made

here to present some guidelines for merger, to explore economics, financial and human problems in merger.

Legal problems which may be involved in mergers of farm mutual insurance companies are not covered in this publication. Laws differ in each state. Before and during merger negotiations laws governing operations of farm mutuals in the states involved should be studied, and the State Insurance Commissioner should be contacted.

Introduction

Agricultural firms serving American farmers grow, stay the same, or decline in a continually changing economic environment. As this environment changes, so must firms' growth methods.

A large number of farm mutual insurance companies in this decade face the problem of whether to grow by merging or by some other method. Times have changed since many existing farm mutuals were formed, and so have farms, roads, means of communication, and transportation methods and equipment. It is possible for a farm mutual insurance company to serve farmers effectively over a much wider territory than even a decade or so ago. Moreover, larger farm mutual insurance companies serving larger areas can provide more extensive coverages and services, and afford a higher level of management. Merger is one way farm mutuals can more adequately serve farmers.

Farm mutual insurance firms are not alone in considering the need to increase the size of business. Basic economic trends, such as fewer and larger farms, have affected many business firms. The basic social and economic forces that are causing change in farm mutuals are also causing change in rural banks, rural newspapers, feed manufacturers, country elevators, fertilizer

plants and other related firms. In search for efficiency and lower overhead costs, they likewise have been expanding through merger or other methods.

There is widespread use of the term merger to cover consolidation or acquisition as well as merger. Technically in merger, two or more farm mutuals would be joined together with only one association continuing to exist. On the other hand, consolidation represents creation of a new company by two or more companies who lose their identity in the process. However, the term is here used in the broad sense to include consolidation, acquisition and merger.

Mergers are not new in the farm mutual insurance field, but they have gained importance in recent years due to the rapid change in agriculture which often calls for stronger companies.

Number of Mergers

In an eight-year period, 1946-1954, USDA data indicated that of 1,843 farm mutual insurance companies considered, 119 disappeared or dropped; 49 percent or approximately 60 companies were consolidated. ^{1/} These mergers or consolidations took place in nearly all states although the highest portion was in the midwestern region. They included various types of farm mutuals, though most of them were farm mutual fire companies, and most of them were companies with under \$2 million insurance in force. Present indications suggest that the trend toward merger is increasing in intensity in the farm mutual industry.

The desire of farmers to build strong efficient farm mutuals has given impetus to merger in recent years. In some cases, merger has been the only way companies

could continue to exist. The major forms mergers have taken in farm mutual property insurance have been (1) for two or more companies to join forces and continue with the same line or increase the line of protection, and (2) for smaller companies to merge with multiple-line companies.

It is not easy to merge. Sometimes it is even difficult for farm mutuals to make the changes essential to survival. In merging individual companies it is necessary to tailor-make the merger job to fit the situation. It is not easy to create a new organization out of existing ones. Planning, agreement and arrangements are necessary to give life to the new organization.

Economic Basis

The principal reasons for farm mutual insurance company mergers are economic. Merger becomes attractive whenever there appears to be an opportunity to (1) realize lower cost insurance, (2) increase the services provided, (3) reduce operating costs, (4) enlarge the geographic territory a company can serve, (5) increase the lines of insurance that can be provided, and (6) provide the farm business with a continuing farm mutual company which can meet the needs of and provide services to its clientele over time. Merger may also be attractive to management if it is envisioned as an opportunity for personal gains.

Farm mutual members may be interested in marshalling facts to answer yes or no to the question--would they be better off if their association merged? It is important for the farmer member to realize that the merger question relates to the basic objective of the company, which is economic benefits for members through low cost for the lines of farm property protection that farmers desire. In considering merger, timing is extremely important. If the future

^{1/} Agriculture Information Bulletin No. 165, U. S. Department of Agriculture.

appears to hold merger, would a company be ahead to merge now or take the chance of losing the better risks to competitors, thus leaving a company with lower class risks and perhaps a lower surplus to merge? Hence, if merger is being considered, attention should be given to when a company will be in the strongest position for merger.

Bringing about an effective merger depends on the attitude and ability of the people assigned the responsibility for carrying it out. Even though members tend to gain economic advantages, there is no assurance these can be realized if the members or farm mutual management are indifferent or incompetent in completing the merger. Economic analysis can only indicate whether dollars and cents advantages might be realized. No study can assure that possible benefits will be translated into actual benefits because much depends on the people concerned.

Economic Environment. --Any study of likely benefits to be derived from merger should take into account the economic environment in which it will take place. Among the most useful economic areas for appraisal are: (1) The future of the economy. In looking ahead during the next five or ten years, can the farm mutual leaders expect depression, economic growth, or maintenance of this status quo? If a depression, how severe? If economic growth, will it be at a rate that will affect operations of the farm mutual? Will the trend toward bigness in most agricultural industries continue, and to what extent does this suggest change in the farm mutual? This is especially important in terms of change in other firms that serve farmers as their changes affect farmers' shopping habits and use of mer-

chant and dealer credit. If these areas appear favorable, a merger may stand a better chance of success.

(2) Trends in agricultural production and farm insurance needs. Will the trend toward fewer and larger farms continue? Will technology result in increasing food production at a faster rate than total demand is increasing? Specifically, an area may be going into or out of hog production with the consequences that the demand for farm property insurance on swine handling equipment and housing would increase or decrease greatly. Other areas may be going basically into or out of grain or other livestock production. These changes would result in marked shifts in the need for specialized coverages on particular types of insurable farm property. Also, in some geographic areas, population change from rural to urban is increasing in tempo. Will farm mutuals be able to provide protection for non-farm residents and, if so, what lines of protection will they be able to provide?

(3) Trends in competition. Will competing companies be able to take a significant amount of business from the specialized farm mutual company? If so, the opportunity to merge and offer a wider line of coverages may appear particularly attractive. 2/

The following comments by a former manager (a) of a specialized farm mutual fire company and a manager (b) of a multiple-line company illustrate coverage problems that specialized companies face in terms of meeting competition.

(a) "We had a \$100,000 surplus and were doing well by comparative standards.

2/ In many states multiple-line stock and mutual companies have recently introduced a farm package policy which includes more lines of coverage than the farm mutuals have been able to provide at rates 10-40 percent lower than purchase of separate policies for each of the coverages offered in the package.

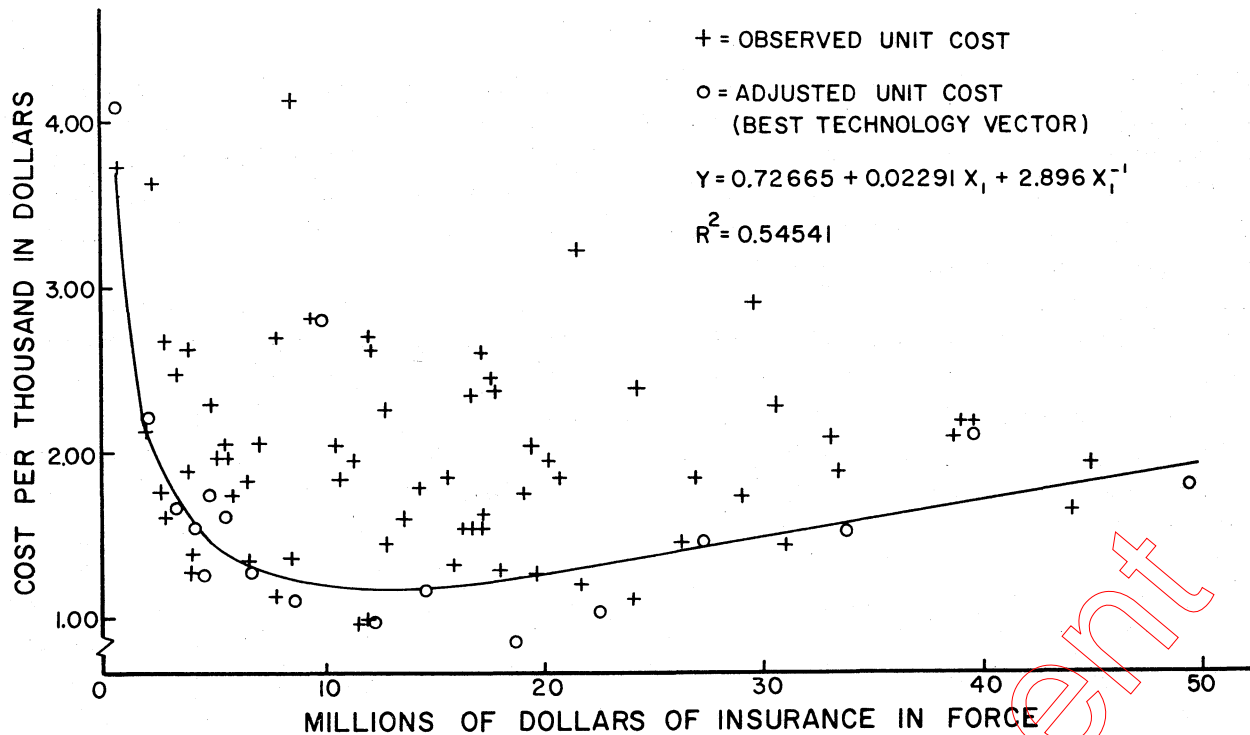


Figure 1. Estimated long-run average cost curve for Illinois fire-only companies with insurance, based on 1956-1960 average costs and 1959-1960 average insurance in force.

But we could see the handwriting on the wall. We were located in a farming area that will continue to increase in agricultural importance. Our farmer members were going to need broader coverages than we could provide (fire and lightning). We had been writing a combination policy with a multiple-line company which made it easier for us to merge with them. Three of our directors stayed on with the multiple-line company as agents and are making more money than they did with our company. We retained nearly all of our policyholders for the multiple-line company."

(b) "The manager of a multiple-line company in a state where many mergers of farm mutuals have taken place commented, 'Farmers are buying the farm package policy--small companies just cannot begin to meet this competition and they have merged while their financial positions were strong and they could still get a good deal.'

Independent agents in our state are demanding more lines from one company. The part time agent is a phenomenon of the past. We will have full-time, well-trained agents in the future."

Economic Consequence. --In exploring the economic consequences of merger, farm mutual leaders may want to consider: spreading overhead through the use of fewer facilities, product line, use of personnel, and operating practices.

(1) Use of facilities. Farm mutuals are confronted with changing trends in the use of their facilities. To some degree, economies of size occur in the use of office facilities and equipment. To illustrate, it costs less per person to provide office facilities for 10 office personnel than for 5 personnel. If a merger of two or more small farm mutuals results in the use of relatively fewer but larger office facilities,

the per unit costs of insurance could be reduced. A recent study by Purdue University dealing in part with costs involved in the operation of specialized fire companies showed that there are substantial economies in the operation of these companies to a size of about \$10 million of insurance in force. Figure 1 shows the results of this study for specialized farm mutual fire-only companies operating in Illinois. These cost-insurance in force data are representative of other specialized farm mutuals operating in Illinois and Indiana. ^{3/}

Any exploration of merger, therefore, should include careful examination of where facilities are located, and whether it will be possible to serve the combined membership by use of fewer facilities. If office facilities are favorably located and fully utilized it may be possible to reduce the total operating costs by as much as 20 percent by merger.

(2) Product line. Perhaps one of the most important reasons that specialized farm mutual fire and fire and windstorm companies are considering merger is because product line can be increased. Selecting companies to merge with should be carefully considered. For instance, would the newly merged company have to establish additional lines or would it be more advisable to merge with a company that already is writing a wide line of coverage? In many cases individual farm mutuals have been able to offer only fire and limited extended coverages. Through merger, companies may be able to establish a large enough surplus and wide enough trade territories so they can offer both fire and wind and other lines of coverage such as general farm

liability. Another common arrangement has been for specialized fire companies to merge with multiple-line companies in an effort to expand the product line for policyholders of the specialized companies.

An example of a successful venture in merging specialized companies in an effort to offer broader coverages is summarized by a former manager as follows: "Three of our specialized fire companies operating in two counties merged. We had one natural leader in the group and he was chosen as the manager. We retained most of the directors to serve as solicitors for the new company. In a three-year period, we more than tripled the volume of insurance in force that the three companies had before the consolidation. We did this partly through being able to offer a wider line of protection which opened the door for new customers and we also increased the insurance to value on farmer property that we had insured."

(3) Use of personnel. Opportunities to reduce personnel costs resulting from mergers should be explored. It is possible, for example, to achieve economies in management costs. If two farm mutuals merge there is need for one general manager instead of two; and when the companies are small, one or two bookkeepers instead of two or more, one office manager instead of two, one sales force manager instead of two, and so on down the line. Likewise, it would be advisable to determine to what extent these reductions may be partially offset by higher salaries needed for more competent personnel. This is especially true if two or more specialized companies merge that do not have personnel who have experience with liability and other coverages to be added.

^{3/} For further discussion of costs and operating practices of farm mutual insurance companies, see Krause, Kenneth R., "An Economic Analysis of the Operational Efficiency of Farm Mutual Insurance Companies", unpublished Ph.D. Thesis, Purdue University, 1963.

Also, the effect of losing the close ethnic ties evident in farm mutual companies, for which the low moral hazard claim has been stressed, requires examination.

However, it should be emphasized that success is achieved if managers and directors have ability to grow as the company grows. Another side, however, needs to be considered. To what degree do opportunities prevail for more effective use of personnel when farm mutuals join forces? For example, the merged farm mutual, because it is larger and stronger, may more readily obtain and retain competent personnel. Personnel may find greater responsibilities and more challenging opportunities in such an association. Salaries may also be increased accordingly. Opportunities that merger may provide for developing and holding a second echelon or middle management group ready to step into top management positions when needed should be examined.

Persons responsible for obtaining facts may want to determine if additional services can be provided when farm mutuals merge. This has special application to smaller farm mutuals. It may relate to a wide range of activities--for instance, specialists in membership and public relations; more effective accounting services, including opportunities for mechanized accounting; specialists in employee training, credit control, and personnel; and possibly a part-time research staff.

(4) Operating practice. Basic in evaluating any plan for merger is the influence such action may have on business operations. The following questions, while far from all-inclusive, are suggested. (a) If joint action is contemplated, which of the various forms--merger, consolidation, or acquisition--is the most feasible? For example, to what extent will such matters as these help or hinder a new operation--the nature of various economic forces bear-

ing on the proposed joint action, the objectives of directors and managers, the understanding of members, and their understanding or lack of desire to understand the proposed joint action? (b) To what extent do differences in operating methods influence or improve opportunities for such action by introducing flexibilities into operating practices? (c) When the farmer of tomorrow considers merger of his farm mutual, he will want to know how effective it would be in providing basic coverages he needs at lower costs. What will the merger mean in terms of serving large, small, and part-time farmers as well as farmers engaged in all types of operations?

Examples of successful mergers in terms of costs and an expanded line of coverages are summarized by a former company secretary and a present manager as follows:

"We had financial trouble and the insurance commissioner insisted that we raise our rates or merge. Our financial trouble arose partly because we did not use reinsurance and partly because we were one of five companies operating jointly in the same county. We reinsured each other, and directors of all the companies wrote for all of the five companies. In many cases, we were insuring at too high a ratio of insurance to value. After the merger with a multiple-line company, our policyholders were able to purchase a wider line of farm property insurance at reduced rates."

"The insurance department insisted that they merge since they had been in financial trouble for about five years. There was less than \$4 million of insurance involved but it gave us a virgin territory to work in, and we have done all right in writing multiple-line coverage in their territory."

(d) Will merger contribute to increased bargaining power with reinsurance and larger insurance companies?

(e) Merger may influence changes in location of company representatives. Farmers will want to know what effect merger may have on where representatives will locate and operate.

In summary, the final economic test is: Will well-planned and carefully worked out merger arrangements provide farmers with an opportunity to increase their incomes through more effective business performances of their farm mutuals? Limited farm mutual research suggests that in some instances merger may be in accord with the needs and trends of the time. Farm businesses are much larger, farm and business operating technology has changed, as have techniques and procedures in management.

Human Relations

The focus of this section includes farmer members, employees and directors of the firm, and the community in which the firm operates--in essence, the general public.

The human resources of a farm mutual may be considered "publics." Among these are many special groups--members, employees, customers, firms that supply or service the farm mutual, competitors, and other groups in the community. All are affected by the farm mutuals and in turn affect the farm mutuals' operations. The "publics" are, or should be, part of the human resource of a farm mutual. Success in dealing with them is a major key to success in joining together two or more farm mutuals by merger or consolidation.

Achieving effectiveness in the use of human resources calls for a knowledge of human behavior and the application of this knowledge through all available channels of communications. This poses problems. Answers to some of these are considered under the headings: member relations, employee relations, and public relations.

Member Relations. --Farm mutual merger may involve membership problems such as pride of identity; giving newly acquired members proper and proportionate representation; expecting too much of the new organization; overcoming long-standing rivalries between groups being merged, and member participation in the new organization. 4/

Solution to membership problems lies in careful advance planning, knowledge or anticipation of what problems may arise, and maintaining good communications.

(1) Solutions must be tailored to a particular situation. The ideal would be to anticipate problems before they arise and take steps to avoid them. But such actions should be based on experience. The following is an example of experiences of a farm mutual manager who has considered merging actions.

(2) Price of identity. "In certain parts of our area there is acute need to consolidate the operations of small farm mutuals which appear to face future difficulties." A manager of a small specialized farm mutual reported that these difficulties stem from the current trend toward larger and fewer farm units in his farming area, and "despite the pressing need, very little progress can be made in merger due primarily to resistance to loss of identity,

4/ "Mergers for Stronger Cooperatives," Reprint 208, April 1961, Farmer Cooperative Service, USDA, p. 8.

reluctance to close the farm mutual doors, and competitive history among the farm mutuals."

(3) Giving the proper presentation. Many farm mutual leaders agree on the necessity for careful advance planning so that members of a farm mutual being merged are properly represented in the new organization. From the standpoint of human relations, this means a plan that members believe is fair and reasonable to them.

(4) Expecting too much of a new organization. This can be a problem in merging farm mutuals. The answer is not to over-promise during the discussion of the proposed merger.

(5) Overcoming long-standing rivalries. This situation is apt to confront farm mutuals seeking to join forces for more effective action. When farm mutuals are small and situated relatively close together, it is not uncommon for two or three to solicit business from the same farmer. Faced with the need to merge, managers and boards of directors who have been rivals suddenly find that they must sit down at the same table with their former rivals.

These comments by the manager of a farm mutual insurance company emphasized the problems: "As a manager of our farm mutual, I believe that a merger of the three farm mutuals in our geographic area would be for our common good. Due to personality conflicts, however, I feel that it would be better for the suggestions to come from outside." In some cases outside help and the employment or retainment of a third or fourth outside impartial party can accomplish the goal of farm mutuals in proposed merger situations.

(6) Encouraging member participation. When membership of an organization has expanded through a merger process, an

increased demand for membership work is often called for. Members of the new organization should be kept fully informed about company operations. One device for forming loyalty between the member and the farm mutual is to put the member to work, by reinforming members of company objectives, by encouraging them to obtain new members for the company, or through their participation in inspection programs and other activities of the company. This is particularly true in a merger.

Employee Relations. --Another problem encountered in joining farm mutuals involves personnel. Several problems arise.

(1) What to do with excess personnel. The most important device for solving this is to plan ahead of the actual merger. In this way employment may be found for many employees, and they won't suddenly find themselves without employment.

The problem of excess personnel was essentially non-existent or easily solved in the following situations summarized by former and current company managers.

(a) "We had financial trouble. The towns and cities were growing in our area and farming was becoming less important. Our biggest problem was with our directors. They all were past 60 years of age and had little interest in the company, and we could not get younger farmers interested in serving on our board. Since I had served as an agent for a multiple-line company, it wasn't difficult to merge with them."

(b) "They were operating a good company. The manager's wife did most of the work and after she became sick, the directors came to us and asked what we could do for them. It was simple to merge with them since we both used the same reinsurance group. We kept two of their directors to serve as directors for us."

(c) "We were a very small company with less than \$2 million of fire insurance in force, and our directors had no desire to continue operating the company. Our company was founded around our church, and after it closed our company membership dropped considerably."

A second method of handling excess personnel is to make use of normal attrition. As employees leave the organization for one reason or another, jobs can be eliminated or consolidated. Other methods of reducing hardship is to give plenty of advance notice. If possible, it is well to try to find employees other positions in the community.

Some managers of smaller farm mutuals have realized that their alternatives were either acceptance of a reduced position with a stronger company, or continued operation and sooner or later being without employment because the company would be forced to cease operating. In many farm mutuals merging, personnel have been reduced or are at a minimum, and the major concern has been employment of the secretary-manager. In most cases managers have been retained by the surviving company in which the small farm mutual has been merged. Other employees and board members have been retained in some instances. Personnel problems have then been solved by applying the personnel policies of the stronger organization.

An approach such as this could be used: Employees of several farm mutuals being merged into a larger, stronger organization could be guaranteed employment for at least one year following the merger. At the end of the year those who fit into the new program would be retained. Employees who for one reason or another did not find a place in the new organization would be released. In many instances employees of the smaller farm mutuals have benefited as

a result of assured continuing employment, increases in compensation and other employee benefits usually extended by a stronger organization.

(2) Loss of job status. In some merger cases where declining or smaller organizations join with stronger ones, employees of the smaller organization may lose job status. In these cases the best solution is a strong personnel program, including such activities as in-service programs to teach employees about the firm, fringe benefits which larger organizations usually provide, and a membership publication to acquaint the employee with the organization.

(3) Developing employee loyalty. Following a merger salaried personnel may fail to develop a strong loyalty to the new firm. Here again a good personnel program can be helpful.

(4) Loss of personal community status. Personal status, particularly in small towns, can be extremely important to the employee. It is one thing for a man to be the manager of a local association; it is quite another thing for the same man to become the manager of the local unit of a larger organization whose head office may be a hundred or more miles away. This may influence the attitude of key employees toward a proposed merger, and they may influence the decision of directors and company members to act unfavorably on a proposal to merge.

Relations with the General Public. -- In current thinking about farm mutual mergers there runs a single thread--one key to successful merger is careful attention to human relations and to good communications with directors and members. It is imperative that the newly merged firm earn community acceptance by the manner in which it conducts its affairs, the services it per-

forms, and the degree to which it accepts community responsibilities. A new firm, even in an old location, is a new face in town. Public acceptance of the new firm does not come automatically. It must be earned.

The difficulty boards of directors frequently have in understanding the over-all factors involved in merger is not easily resolved. Frequently, the goals of maximum returns to the farmer and the need for a stronger organization are lost sight of, and attention is focused on items of little economic importance to the membership. Since the membership of a farm mutual often follows the recommendations of its board of directors, the board members that are frequently one key to successful merger should be well informed on the over-all and long-range benefits that can be achieved.

In many merger cases educational work has been done among members before and as part of the merger procedure and has led them to accept such merger as desirable. In most cases membership relations among original members of the smaller farm mutual have been improved.

Financial Problems and Procedures

The end product of a farm mutual merger or consolidation is an expanded set of assets, a realignment of liabilities, and an enlarged group of owners of the business. 5/

Much time, money and effort is saved if balance sheet values of a certain data are acceptable as a basis for merger. In practice there may be understandable reluctance to accept balance sheet values as the basis for merger. The reasons for reluctance are: Transactions may not be

accounted for on the same basis; the nature of the assets being acquired may not be determined accurately; and future operations may be affected by information regarding assets obtained by accountants and appraisers.

Specific situations give rise to financial problems of three types.

Valuation of Assets. --The common problem areas in valuing assets are: (1) Have accounting systems of the farm mutual adequately reflected operating results? (2) Do accounting systems adequately reflect financial conditions? (3) What adjustments are needed to obtain the greatest degree of comparability between financial statements to the organizations? (4) Who will appraise the value of the assets? (5) If negotiating companies hold to the belief that "good will" is transferable and should be paid for, how should the value of this asset be determined? (6) Will the merger involve acquisition of all assets or will those of little or no utility value be excluded?

The usual picture when merger is discussed is that of a financially weaker company merging with a financially stronger one. In such a situation the stronger company acquires the assets of the weaker company and assumes its liabilities. The equities of the weaker company which, by simple arithmetic, are equivalent to the excess of the total assets over the total liabilities are "traded in" for cash, or for protection in the stronger association--or for a combination of both. The weaker association, by agreement, ceases to exist and the stronger one is the surviving association. In some cases where the state insurance law permits, the assets of the merged company are used to pay the insurance premiums for policyholders who elect to stay with the surviving company for the first year or two.

A rather curious but nevertheless practical situation arises when there is a weaker-or-stronger farm mutual merger situation. Non-financial trumps, such as giving up the company name and facilities, seems to be held by the weaker company in many cases. There is an understandable tendency to over-look poor performance, operational or financial difficulty and to "go easy" on extracting the last pounds of flesh. It is sound business to make the financial settlement on the basis of an appraisal. At this point, what were originally academic figures on a balance sheet become alive and meaningful. How good is each and every receivable?

Should negotiators accept the depreciated value of fixed assets as the fair value? What methods are to be used to depreciate the fixed assets? Straight line or reducing in fraction? In this inflationary period, professional appraisers generally may up fixed asset values somewhat higher than net book value, for the reason that they generally appraise on the basis of replacement costs less straight line depreciation back to the date of acquisition. In addition they may make an adjustment based on their own experience, taking physical condition into account.

Are there any other unrecorded-record assets? Are there any contingent liabilities, pending litigations, or contractual arrangements that are on record in the balance sheets except perhaps as footnote comments?

Payment for Assets. --In this area, farm mutuals become involved in: (1) In what form shall payment be made--cash, notes, debentures, book credit, certificates of interest or advanced payment on insurance in the new organization? (2) If part or all the payment is cash, should it be a lump sum payment or spread over a period of years? (3) On what basis is finan-

cial settlement to be made to policyholders or creditors who object to merger? (4) How are settlement values to holders of certificates of indebtedness of differing maturities determined; and of reserves allocated to individuals over such a long period that there is a real problem locating them? (5) Is there anything in the organization papers of the company to be dissolved concerning distribution of capital gains or losses which may create serious obstacles to merger.

In some cases these problems have been resolved by paying creditors of the company being merged and then prorating the remaining assets of the merged company among members and giving them the option of depositing the assets with the surviving company as advanced premium payment. Before it is decided to distribute the assets in this manner, the question of whether the newly formed or surviving company can afford a reduction in its working capital and assets should be answered. Also, state insurance laws vary on how the assets of merged companies can be handled. The law should be consulted before action is taken.

The important point is that, although a satisfactory financial settlement for assets may be agreed upon by the people responsible for merger, if the manner of distributing them creates legal and membership problems, the nature of these problems should be ascertained early in negotiations.

Projecting the Financial Position. --The third category of financial problems--financial strength of the new organization--deals with projections and may be summarized: (1) Will a newly formed organization provide for adequate financing to meet the demands of normal business and normal expansion? This could be especially critical if the merged organization brings no additional surplus to a company but brings a much greater amount of insurance in force

against the surplus of the surviving company. (2) If the merged company brings no surplus to the new organization, where will additional assets be secured if needed? (3) When merger is consummated will the ratio of debt to equity capital be more or less favorable from a credit standpoint? (4) Will the newly formed organization be in a better position to obtain funds for working capital or expansion purposes than the component organizations individually seeking funds from the same sources? For example, some lenders feel that in unity there is financial strength. (5) What projected operating results will be anticipated in terms of insurance costs to farmers, and can the assets of the surviving company be expected to grow at a faster rate? (6) Who will be responsible for the assumptions to be made in projecting operations?

Negotiators of merger may find it useful to project operations in statement form to show what management hopes to accomplish with the expanded resources. Such a projection helps managers and members understand how anticipated changes in dollar volume, cost reduction, shifts in or disposition of fixed assets, and other proposed operating efficiencies can result in increased returns.

A Projected Financial Statement.

In Table 1, a simplified financial statement is shown for two companies before and after merger. In this example the smaller fire-only company merged with a larger fire and windstorm company. The assets of the fire-only company were small and a very limited amount of fixed equipment was involved. A majority of the policyholders of the small company stayed with the new company; thus, at the time of merger the assets and amount of insurance in force increased in the new company.

Summary of the operations of the new company at the end of the first year

indicated no significant increase in company assets, but the insurance in force increased measurably, while the number of policies decreased.

The five-year results indicate that the merged company was able to increase the surplus, lower the rate per \$1,000 of insurance protection to policyholders, pay a higher management salary, and substantially increase the insurance in force.

Steps in Merging Farm Mutuals

To this point the analysis has indicated three general areas to explore--economic, human and financial. These areas raise questions such as: How to go about studying the various points? What steps or procedures to take? Is timing of certain actions important? How to best organize to bring about a merger--to avoid stumbling blocks?

No two mergers have been achieved in exactly the same manner. There is no one best way to fit all conditions. This section lists some of the more important steps that companies have followed. They are grouped into four stages.

The Idea Stage.--This is the seed-planting and germinating stage. Some of the initial steps are: (1) Directors and managers of the initiating companies informally discuss merger possibilities at board meetings. This idea may grow from the manager or directors hearing or reading about merger explorations or achievements by other farm mutuals. They discuss in broad terms the need and the possibilities for combining with one or more farm mutuals. (2) Directors or the manager "feel out" the idea with one or more other farm mutuals. The use of a third impartial party may be useful at this as well as at later stages in bringing two or more companies together. If the board exhibits interest, it may suggest and arrange for an exploratory meeting with directors and managers of the

Table 1. Financial statement

	Company A 12/1955			Company B 12/1955			Merged company 12/1956 12/60			Merged company 12/1961 12/65		
	<u>INCOME</u>											
1. Amount of ledger assets	\$	\$	\$ 200,000	\$	\$	\$ 30,000	\$	\$	\$ 230,000	\$	\$	\$ 310,000
2. Gross receipts:												
Fire	25,000			10,000			40,000			62,000		
Windstorm	10,000						20,000			25,000		
3. Total receipts deduct		35,000			10,000			60,000			87,000	
4. Paid for reinsurance	6,000						9,000			10,000		
5. Returned on cancellation	500			1,000			2,000			1,000		
6. Total deductions	6,500			1,000			11,000			11,000		
7. Net assessments & fees	28,500			9,000			49,000			76,000		
8. Interest on investment	7,000			400			9,500			11,000		
9. Total income			35,500		9,400		58,500			87,000		
10. Total assets & income			207,000			30,000			238,400			319,000
	<u>DISBURSEMENTS</u>											
1. Gross losses paid:												
Fire	4,000			6,000			28,000			36,000		
Windstorm	6,000						8,000			14,000		
2. Loss recovered from reinsurance	4,000						8,000			11,000		
3. Net losses paid		16,000			6,000		28,000			39,000		
4. Adjusting expense	500			200			1,600			1,600		
5. Commissions	2,000			600			4,000			3,800		
6. Salaries of agents and directors	500			300			1,000			2,000		
7. Management salary	6,500			2,000			9,000			12,000		
8. Office help	2,500			100			4,000			6,500		
9. Office expense	500			100			1,000			2,000		
10. Other				100			500			1,000		
11. Total expense	12,500			3,400			22,100			28,900		
12. Total disbursement	28,500			9,400			22,100			67,900		
13. Total assets and income			207,000			30,000			238,400			319,000
	<u>EXHIBIT 1</u>											
Number of policies			1,950			900			2,600			3,000
Average net retained insurance in force			\$12,000,000			\$3,500,000			\$20,000,000			\$34,000,000
Net premium retained			28,500			9,000			49,000			76,000,000
Net losses			16,000			6,000			28,000			39,000,000
Company surplus			207,000			19,600			228,500			310,000

other companies. More than one meeting may be necessary. (3) Directors appoint a consolidation or merger committee. If each company reacts favorably, then each may want to appoint representatives to a joint study committee to examine all aspects of merger. Such a committee frequently consists of two or three directors from each company, with the manager or assistant managers as ex-officio members. In practice, the manager can be very important in compiling information, exploring alternatives, and encouraging the directors.

The Study Stage. --The committee, working on its own and contacting other merged companies, may develop a satisfactory basis for merger action. A thorough study will examine all the various aspects involving economic, financial, human, and legal phases.

Frequently, however, merger committees and boards of directors desire help in studying various problems. For this reason, the boards of directors should specifically outline the authority of the merger committee in obtaining outside assistance at the time the committee is appointed. Some outside assistance may require expenditures by all companies involved.

(1) The first step in the study stage is for the merger committee to initiate study of the proposed merger and to outline the information required and areas where recommendations must be made. Individual members of sub-committees may collect information on various phases, such as facilities, operation, or member equities, with the assistance of general managers and staffs of their farm mutuals. Conclusions and recommendations are formulated where possible. The committee should set up a time table with target dates for various steps or reports to help assure action without undue delay.

(2) Merger committee requests needed assistance from public and private agencies. Farm mutuals can obtain assistance from agricultural economics staff and Extension specialists at state universities. Other sources of help are the Agricultural Finance Branch and the Farmer Cooperative Service of the U. S. Department of Agriculture, state associations of mutual insurance companies and the National Association of Mutual Companies.

(3) Merger committee reviews findings of agencies helping with the study. Information from these agencies mentioned may be sent to the committee a week or two ahead of the meeting called for discussion. A suggested procedure for presenting and discussing the report, or reports, may be: first, the person making the study should present his findings orally to the committee; second, representatives from each farm mutual would then meet alone to determine points of agreement or disagreement; third, the committee would meet together again to share views and ask questions. Members may suggest alternatives to be examined. The full board of directors of the farm mutual may wish to sit in on the meeting when the outside agencies report to the merger committee. In this case, it should be understood that the merger committee still has responsibility to complete its study and make recommendations. This may vary from complete acceptance and endorsement of the agency report to its modification or even rejection.

The merger committee may require several hours or more to hear and discuss the report of an outside agency. In many cases, all three steps proposed above may be completed in a relatively short period. After the merger committee of companies involved has considered the reports of outside specialists, the committee should then prepare a final report taking into account suggestions made by the boards of directors.

The completed study should include a detailed examination of possible benefits in terms of insurance costs, efficiency, lines of coverage, and service; a basis for a merger that is equitable; and also should consider other problems such as possible points of conflicts, and limitations of various kinds.

The Proposal and Compromise Stages. --In this stage open minds, sincerity, and statemanship must prevail if the interests of members are to be served. Willingness to compromise may mean the difference between a merger and no merger. Neither farm mutual involved, especially the largest and strongest, should insist on the "last drop of blood" if the merger is to become a reality. In this stage the following actions will be needed.

(1) Merger committee reports to a joint meeting of the boards of directors, providing an opportunity for the leader in each area of study to present his report, and for oral reporting of outside agencies. The same steps may be followed as in the merger committee hearing reports of outside agencies; first, a joint meeting; then separate executive sessions; and then a reconvened joint meeting.

Agreement on the basis of merger may then be reached by boards of directors. It is desirable that all directors of each farm mutual support the proposal; but if this is not possible, the by-laws of the companies involved should be followed.

(2) Merger committee prepares a written proposal for merger, outlining the basis for merger accepted by boards of directors of the farm mutuals.

(3) Attorneys prepare agreed upon merger proposals in legal form to submit to members. Also, explanatory notes may be desirable. Attention should be focused

on laws of the state regarding merger and in making them clear to the members.

The Merger Approval Stage. --This can be termed the membership information and voting stage. Steps should include the following:

(1) Directors of each association call a special meeting of members to vote on the merger. Mail ballots usually are necessary to obtain the required proportion of votes under law. A full and clear explanation of the proposal should be sent to each member.

(2) Directors of each association strongly urge approval of the merger proposal. After Directors have voted to recommend a consolidation or merger, they should actively support the idea. While a merger proposal should be presented objectively and not oversold, some forceful action by directors usually is necessary to get approval by members. Local informational meetings ahead of the meeting called for voting on the merger may be desirable. Articles for member publication and special letters may be used to explain details of a proposed merger and reasons why members would benefit.

Ample time for discussion should be provided at special meetings. Both pros and cons should be presented, but it should be clearly evident that probable advantages will outweigh the disadvantages.

(3) Hazardous hurdles. It is important that leadership avoid dissipating detours and be prepared to overcome some obstinate obstacles. Several other things which can cause negotiations to falter or breakdown at an early stage are: (a) Premature release of information. It is desirable that the committee and the directors work with discretion and release publicity jointly and only with the consent of the

merger committee. Also, such releases should reveal only that studies are under way and any plans that have been definitely formulated. Members should be informed of the studies under way, because what many of the members are likely to learn from outside sources may not portray the anticipated action in a favorable light. (b) Too early discussion on the role or assignment of employees, especially the manager. Tentative selection of the manager and other employees for the proposed merged association can easily upset personnel in each organization, divide directors and break down objective discussion. Only the new board of directors of the merged companies can ap-

point the manager. (c) Too early discussion of a new name for the unified association. This can detour directors off the main track and use considerable time at meetings. (d) Over-emphasis on solving short-term problems rather than long-term benefits to policyholders.

There are many stages or steps in completing merger plans. Some of these overlap. The timing and sequence may vary, but at some time during negotiations the board and managerial employees will be involved in the stages discussed--idea, study, proposal and compromise, and member approval.

Historic Document